



## Testimony

Before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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# DOD'S HIGH-RISK AREAS

## High-Level Commitment and Oversight Needed for DOD Supply Chain Plan to Succeed

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Highlights of [GAO-06-113T](#), testimony before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Homeland Security and Governmental Affairs, U.S. Senate

## Why GAO Did This Study

Since 1990 the Department of Defense's (DOD) supply chain management processes have been on GAO's list of high-risk areas needing urgent attention and fundamental transformation to ensure that they function in the most economical, efficient, and effective manner possible.

Recently in collaboration with the Office of Management and Budget (OMB), DOD developed a plan to address some of the systemic weaknesses as a first step toward removing supply chain management from the list. DOD's plan focuses on three areas for improvement: accuracy of supply requirements forecasts, distribution of material, and asset visibility.

GAO was asked to provide its views on (1) the importance of supply chain management in DOD, (2) why GAO listed it as a high-risk area, (3) GAO's assessment of DOD's plan to improve supply chain processes, and (4) GAO's plans to follow up on DOD's efforts.

This testimony contains GAO's views on what remains to be done to improve DOD's supply chain management and bring about lasting solutions. Continued efforts to complete and implement DOD's plan as well as continued oversight by Congress are essential.

[www.gao.gov/cgi-bin/getrpt?GAO-06-113T](http://www.gao.gov/cgi-bin/getrpt?GAO-06-113T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact William Solis at 202 512-8365 or [solisw@gao.gov](mailto:solisw@gao.gov).

## DOD'S HIGH-RISK AREAS

### High-Level Commitment and Oversight Needed for DOD Supply Chain Plan to Succeed

#### What GAO Found

It is important for DOD to have effective supply chain management because of (1) its impact on military readiness and operations and (2) the substantial investment in inventory. While DOD maintains military forces with unparalleled capabilities, timely supply support is critical to sustaining them. For example, to support Operation Iraqi Freedom, DOD moved more than 2 million tons of cargo, but shortages of items such as vehicle track shoes and tires hampered operations. In addition, DOD spends billions on supplies. For example, its supply inventory levels have grown in recent years from \$62.3 billion in fiscal year 2001 to \$77.4 billion in fiscal year 2004. DOD expects to spend approximately \$50 billion in fiscal year 2005 for such items and associated operations.

In 1990, we identified DOD's inventory management processes as "high risk" because of long-standing problems such as excess inventory levels, inadequate controls, and cost overruns. Since then, GAO's work has shown that the problems adversely affecting supply support to the warfighter involved the entire supply chain. As a first step toward removing supply chain management from GAO's high-risk list, DOD in cooperation with OMB prepared a plan to address weaknesses in three key areas: accuracy of supply requirements forecasts, distribution of material, and asset visibility.

DOD's plan to improve supply chain management provides a good start and framework for addressing long-term systemic weaknesses and in focusing the multiyear effort to improve supply support to the warfighter. However, successful resolution of DOD's supply chain management problems will require continued efforts to complete and successfully implement the plan. Based on GAO's criteria for removing programs from the high-risk designation, it is important for DOD to sustain top leadership commitment and long-term institutional support for the plan; obtain necessary resource commitments from the military services, the Defense Logistics Agency, and other organizations; implement proposed improvement initiatives across the department to address root causes; identify performance metrics and valid data to use in monitoring the initiatives; and demonstrate progress toward meeting performance targets.

As part of GAO's periodic reassessment of high-risk areas across the federal government, GAO will be assessing DOD's progress in resolving supply chain management and its other high-risk areas. GAO plans to follow up on DOD's actions to improve supply chain management in three ways. First, GAO will assess DOD's progress in implementing recommendations made in prior GAO reports. Second, GAO anticipates evaluating several of DOD's supply management activities as part of our planned engagements over the next 2 years. Third, GAO expects to work with other audit agencies, as well as DOD and OMB, to coordinate audit coverage of the initiatives, metrics, and data system validity.

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Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss GAO's list of "high-risk" areas within the Department of Defense (DOD) and, more specifically, DOD's plan to show to progress toward the long-term goal of resolving problems and removing supply chain management from our list. At the onset, I would like to thank the Subcommittee for its continued encouragement of the Office of Management and Budget's (OMB) effort to work with agencies over the next several years to reduce risk in each of the 25 high-risk areas we reported in January 2005. The active involvement of this Subcommittee is essential to ultimately ensuring DOD's continued progress in addressing and resolving its high-risk areas, while enhancing public confidence in DOD's stewardship of the hundreds of billions of taxpayer funds it receives each year.

Briefly, our high-risk list focuses on major government programs and operations that either need urgent attention and transformation to ensure that the U.S. government functions in the most economical, efficient, and effective manner possible, or that are at high risk because of their greater vulnerability to fraud, waste, abuse, and mismanagement. DOD is responsible for 14 of the 25 high-risk areas, including 8 that are specific to DOD and 6 others that are government-wide in scope. This year we added DOD's approach to business transformation to our list of high-risk areas because of our concerns over the department's lack of adequate management responsibility and accountability, as well as other concerns. Business transformation efforts are critical if DOD is to successfully address systemic management problems related to other high-risk areas, including supply chain management. In our view, an essential element to business transformation is strong and sustained executive leadership. As you know, we have recommended a chief management official or similar official be created by statute within the department of oversee DOD's business transformation efforts. We believe that two other essential elements of DOD's business transformation are (1) an integrated strategic plan coupled with a well-defined blueprint—referred to as a business enterprise architecture—to guide and constrain implementation of such a plan and (2) central control of investments in business systems modernization.

DOD's business transformation efforts are likely to have a profound impact across many areas of the department, including supply chain management. For 15 years, DOD's supply chain management processes have been on our list of high-risk areas needing urgent attention and fundamental transformation to ensure that they function in the most

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economical, efficient, and effective manner possible. Senior administration leaders and advisors—including the Secretary of Defense, the nominee for Deputy Secretary of Defense, and the Deputy Director of the Office of Management and Budget—have recently demonstrated a commitment to addressing DOD’s management challenges. To his credit, OMB’s Deputy Director for Management and his staff have been steadfast in their message to DOD about the need for meaningful action and follow-through on resolving problems associated with all 14 of DOD’s high-risk areas. For supply chain management, OMB has worked with the Under Secretary of Defense for Acquisition, Technology and Logistics and his staff to help DOD develop an action plan for improving supply chain management that could reduce its vulnerability to fraud, waste, abuse, and mismanagement and place it on the path toward removal from our list of high-risk areas. OMB has proposed using DOD’s plan describing how it expects to address one of its high-risk areas as a template for other areas on our high-risk list.

During the development of DOD’s plan, we were frequently consulted by OMB and DOD. Based on our analysis of prior reports, we suggested three areas to DOD that would be critical to addressing our supply chain management concerns. After consultation with OMB, DOD identified these three as focus areas for the plan. They are

- improving material requirements forecasts,
- improving distribution of material, and
- improving asset visibility.

In response to DOD’s request for our thoughts on its draft plan, we focused on key elements that needed to be in the plan based on work we have done, recommendations we have made, and our criteria for removal from our list of high-risk areas. We provided OMB and DOD with GAO and DOD reports citing deficiencies in these areas. As guidance for formulating the supply chain management improvement plan, we also provided OMB and DOD with reports containing our criteria for assessing agencies’ progress toward resolving a high-risk problem and determining whether to remove the high-risk designation. We also provided examples where other agencies have succeeded in having the high-risk designation removed.

Today, I would like to provide our perspectives on (1) the importance of supply chain management in DOD; (2) why we have listed it as a high-risk area; (3) our assessment of DOD’s plan to improve supply chain processes; and (4) our plans to follow up on DOD’s efforts.

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In summary, Mr. Chairman, DOD's plan is a good first step in improving supply chain management in support of the warfighter. Notwithstanding this positive first step, the department faces challenges and risks in successfully implementing its proposed changes across the department and measuring progress.

My statement is based on previous GAO reports and analysis. Our work was performed in accordance with generally accepted government auditing standards.

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## Background

DOD is one of the largest and most complex organizations in the world to manage effectively. While DOD maintains military forces with unparalleled capabilities, it continues to confront pervasive, decades-old management problems related to its business operations—which include outdated systems and processes—that support these forces. These management weaknesses cut across all of DOD's major business areas, such as human capital management, including the department's national security personnel system initiative; the personnel security clearance program; support infrastructure management; business systems modernization; financial management; weapon systems acquisition; contract management; and last, but not least, supply chain management. All of these areas are on our high-risk list for DOD.

DOD relies on a number of individual processes and activities, known collectively as supply chain management, to purchase, produce, and deliver items and services to the warfighter. Its goal for supply chain management is to deliver the "right items to the right place at the right time" for the warfighter in support of deploying and sustaining military capabilities as described in the National Military Strategy. The department relies on working capital (revolving) funds maintained by the defense and service logistics agencies to finance the flow of these items to the forces. Working capital funds allow these agencies to purchase needed items from suppliers. Military units then order items from the logistics agencies and pay for them with annually appropriated operations and maintenance funds when the requested items—either from inventory or manufacturers—are delivered to the units.

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## Effective Supply Chain Management Is Important to Supporting the Warfighter and Ensuring Effective Investment of Resources

There are two primary reasons why it is important for DOD to have effective supply chain management. First, supply support to the warfighter affects readiness and military operations. In fact, the supply chain can be the critical link in determining whether our front-line military forces win or lose on the battlefield. Second, given the scope of the supply requirements to support U.S. military operations, the investment of resources in the supply chain is substantial.

While DOD maintains military forces with unparalleled capabilities, timely supply support is critical to sustaining these forces as they are trained and deployed to protect our national security. For example, to support Operation Iraqi Freedom (OIF), DOD moved more than 2 million tons of cargo—including equipment, spare parts, supplies, and other items—thousands of miles to the Persian Gulf. Conversely, supply shortages can adversely affect the readiness of weapon systems. During OIF, for example, shortages of items such as track shoes prevented large numbers of Abrams tanks and Bradley Fighting Vehicles from operating during the summer of 2003. In another case, tire shortages caused units to strip and leave otherwise good vehicles as well as supplies behind.

Shortages of supply items also could hurt the morale of those who employ the weapon systems and raise concerns about forces' safety with their families.

Furthermore, DOD has a significant investment in inventory and spends billions for supplies each year. For example, at the end of fiscal year 2004, DOD had approximately \$77.4 billion worth of items in its inventory, an increase of over \$15 billion since fiscal year 2001, when DOD had approximately \$62.3 billion worth. DOD estimates that the annual costs of supplies and associated operations for fiscal year 2005 are expected to be \$51.4 billion, or about 12 percent of DOD's \$419 billion requested budget. Unless the department has a sound management plan and acts to invest resources to buy and provide supplies to units, improve the supply system, as well as invest in essential information systems, the risk of fraud, waste, abuse, and mismanagement remains high at a time when DOD is challenged to maintain a high level of military operations while competing for resources in an increasingly fiscally constrained environment. We recognize that improving DOD's supply chain management may not save money in the near term because of necessary investments in information technology and other enablers. However, improved systems with timely and reliable data should lead to more effective investment of resources in the future and thereby avoid future costs.

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## Supply Chain Management Is a High-Risk Area Because of Long-Standing Weaknesses

For 15 years, DOD's supply chain management processes have been on our list of high-risk areas needing urgent attention because of long-standing systemic weaknesses that we have identified in our reports. In 1990, we began a program to report on government operations that we identified at high risk for fraud, waste, abuse, and mismanagement. This program serves to identify and help resolve serious weaknesses in areas that involve substantial resources and provide critical services to the public. The department's inventory management of supplies in support of forces was one of the 14 operational areas identified as high risk in 1990 because, over the previous 20 years, we had issued more than 100 reports dealing with specific aspects and problems in DOD's inventory management. These problems included excess inventory levels, inadequate controls over items, and cost overruns. As a result of this work, we had suggested that DOD take some critical steps to correct the problems identified. Since then, our work has shown that the problems adversely affecting supply support to the warfighter—such as requirements forecasts, use of the industrial base, funding, distribution, and asset visibility—were not confined to the inventory management system, but also involved the entire supply chain. In 2005 we modified the title for this high-risk area from “DOD Inventory Management” to “DOD Supply Chain Management.”

Since 1995 we have issued over 70 reports on various deficiencies in DOD's supply chain management system. Our assessment of these reports shows that DOD generally concurred with our recommendations. Furthermore, these reports had several common themes, including DOD's need for accurate supply requirements forecasts, an effective distribution system, and visibility over assets in inventory and while in transit. Moreover, in our prior reports, we have noted problems with the information technology systems supporting the supply chain. For example, DOD has not been able to achieve total asset visibility for over 30 years in part because the department has lacked necessary integration among its many inventory management information systems and has not corrected long-standing data accuracy and reliability within its existing systems. In addition, DOD's nearly 2,000 logistics business systems have suffered from duplication, limited interoperability, and unnecessarily costly operations and maintenance. GAO has not been alone in criticizing these aspects of DOD's supply chain management. DOD and audit organizations such as the Department of Defense Office of Inspector General and the Army Inspector General have also issued studies and reports addressing the supply systems' problems.

DOD defines requirements as the need or demand for personnel, equipment, facilities, other resources, or services in specified quantities



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for specific periods of time or at a specified time. Accurately forecasted supply requirements are a key first step in buying, storing, positioning, and shipping items that the warfighter needs. However, in our April 2005 report on the effectiveness of logistics in support of OIF, we described how DOD had not modeled wartime demands for supplies as required to accurately forecast warfighter requirements. As a result, we found that DOD underestimated the demand in Iraq for some items, such as armor vehicle track shoes, lithium batteries, meals-ready-to-eat, and tires, and forces experienced supply shortages of these items.

Distribution is the process for synchronizing all elements of the logistics system to deliver the “right things” to the “right place” at the “right time” to support the warfighter. In our April 2005 report, we describe several instances where the joint distribution system did not support the forces in Iraq. We attributed these instances to conflicts in doctrine about the authority over distribution, improper packaging of shipments, insufficient transportation equipment and supply personnel in theater, and the inability of the information systems to support the requisition and shipment of supplies into and through Iraq. For example, we found that DOD was not able to effectively distribute sufficient quantities of items such as body armor, meals-ready-to-eat, tires, and generators for Marine Corps amphibious vehicles because of problems with supply chain management.

DOD describes asset visibility as the ability to provide timely and accurate information on the location, quantity, condition, movement, and status of supplies and the ability to act on that information. For over 30 years, the department has been attempting to improve the visibility over its inventory as well as items in transit, and we have repeatedly reported problems with its efforts. The continued lack of visibility over inventory and shipments increases vulnerability to undetected loss or theft; substantially increases the risk that millions of dollars will be spent unnecessarily; and if items are not delivered when needed, may impair warfighter readiness. We have recently reported on DOD’s problems with existing inventory systems being unable to share data on a near real-time basis and concerns related to tracking critical supplies for Iraq. For example, in December 2003 we reported a discrepancy of \$1.2 billion between the amount of material shipped to Army activities in Iraq and the amount of material that those activities acknowledged they received. Since then, in an April 2005 report we reported that the lack of visibility over items in transit significantly affected distribution. For example, incomplete identification tags attached to shipments resulted in the loss of some body armor protection plates, delays in getting meals-ready-to-eat, and the Marine Corps’ ability to only

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verify the receipt of 15 of 140 amphibious assault vehicle generators that were shipped. Improving asset visibility should not only improve data for supply managers' decisions, but should also improve the warfighter's trust in the supply system.

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## **DOD's Plan Is a Good Start toward Resolving Supply Chain Management Weaknesses that Will Require Continued Diligence to Succeed**

DOD's plan to improve supply chain management provides a good start and framework for addressing long-term systemic weaknesses in DOD's supply chain management and for focusing the multiyear effort that will be needed to improve supply support to the warfighter. Notwithstanding this important, positive first step, the department faces many challenges and risks in its efforts to improve the supply chain. First, successful resolution of its supply chain management problems will require DOD to, among other things, diligently complete parts of the plan, fully implement proposed changes across the department, and measure progress. Second, resolution of supply chain management problems will require investment in needed information technology. DOD's supply chain plan includes the Business Management Modernization Program as one of its 10 initiatives. In the plan, DOD recognizes that achieving success in supply chain management is dependent on developing interoperable systems that can share critical supply data. However, we recently reported that DOD had made limited progress developing a common architecture for its business system modernization investments despite having spent 4 years and about \$318 million. Last week DOD, as part of its Business Management Modernization Program, issued an overarching business enterprise architecture and an enterprise transition plan for implementing the architecture. Under the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, we have 60 days to provide our assessment of the extent to which the architecture and transition plan meet statutory requirements of 10 U.S.C. section 2222.

Our assessment of DOD's plan to improve its supply chain management is based on work we have performed, prior recommendations, and the criteria cited in our November 2000 report on determining performance and accountability challenges and high risks. We use these criteria to assess an agency's progress toward resolving a high-risk problem and determine whether to remove the high-risk designation. There are five essential questions to be addressed:

1. Does DOD's plan demonstrate a strong commitment and top leadership support to improve supply chain management?

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The formulation of DOD's plan and its endorsement by the Under Secretary of Defense for Acquisition, Technology and Logistics is evidence of a strong commitment by top leadership to improve DOD's supply chain management. His recent referral to supply chain management as one of the five business areas targeted for improvement by the department's Business Practices and Processes Integrated Product Team as part of the current Quadrennial Defense Review is further evidence of his commitment. However, it is important for DOD to sustain this commitment as it goes forward in implementing this multiyear plan while also engaged in departmentwide business transformation efforts. Because improving supply chain management may be one of several high-risk areas DOD will be addressing at one time, it may take the involvement of the Deputy Secretary of Defense or a chief management official, as proposed by the leadership of this Subcommittee, to ensure that a long-term departmentwide commitment is sustained. In addition, it is important that DOD act to institutionalize this effort by incorporating the elements of the plan into key Office of Secretary of Defense guidance, such as its Logistics Transformation Strategy and its follow-on document called the Focused Logistics Roadmap, that are to guide department activities.

2. Does DOD have the capacity, meaning people and other resources, to resolve the problems with supply chain management?

If DOD makes implementation of its plan a priority, the department has people and other resources to draw from in helping to resolve its supply chain management problems. However, the plan was developed at the Office of the Under Secretary of Defense level, whereas most of the people and resources needed to implement the plan are under the direction of the Defense Logistics Agency and the services. Therefore, it is important for the department to obtain the necessary resource commitments from the military services; the Defense Logistics Agency; and other organizations, such as U.S. Transportation Command, to ensure that the numerous initiatives on which the multiyear plan depends are properly supported. Obtaining these commitments might require the involvement of the Deputy Secretary of Defense or a position such as a chief management official.

3. Does DOD have an action plan that defines root causes, identifies effective solutions, and provides for substantially completing corrective measures over the near term?

DOD's plan for improving supply chain management addresses some of the root causes for problems in three key areas with potentially effective solutions that it may be able to fully implement over the next few years. By

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committing to improve requirements forecasting, material distribution, and asset visibility in this plan, DOD has focused its efforts on three areas we frequently identified as impeding effective supply chain management. DOD's plan for improvement proposes departmentwide implementation of 10 initiatives to help resolve supply chain management problems in the three areas by addressing some of the causes. For example, implementing radio frequency identification technology is expected to provide demand data for forecasting requirements, improve distribution performance, and provide fully automated visibility over assets in inventories and distribution centers. However, the time frames for completing some of these 10 initiatives are of concern. For example, milestones for implementing the Business Management Modernization Program, a critical enabler that will provide the essential information technology underpinning for achieving progress in all three focus areas, are not specifically linked to improvements in requirements forecasting, distribution, and asset visibility. Until the initiatives are substantially implemented across the department, we will not know whether they provide effective solutions to all of the root causes of DOD's supply chain management problems.

4. Does DOD have a program to monitor and independently validate the effectiveness and sustainability of corrective measures?

While DOD's plan recognizes the need and cites a general methodology for evaluating progress associated with each of the 10 initiatives, the department has not yet provided all of the information needed for this to occur. DOD's plan cites a two-step approach. The first step is to have DOD's organizations establish a methodology (internal process) for monitoring the validity of data as part of implementing the initiatives and reporting on metrics. DOD's second step is to rely on independent groups, such as contractors and the Department of Defense Office of Inspector General, to validate the data, and GAO to monitor the department's progress in improving supply chain management as part of its planned audits. Such validation processes are important because, as we have frequently reported, DOD's systems do not have accurate and reliable data, and without valid data, it will be difficult to accurately track progress. However, until DOD specifies all of the metrics and systems it plans to use to measure progress it cannot ensure comprehensive monitoring within the department or that independent groups will know what data and systems should be validated to confirm DOD's reported progress.

5. Does DOD have the ability to demonstrate progress in implementing corrective measures?

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DOD has the ability to demonstrate some progress in implementing the initiatives. However, it has not identified all of the performance metrics necessary to demonstrate how all of the initiatives are affecting supply to the warfighter. DOD's plan identified some viable overall supply chain management performance metrics, including the level of backorders, the amount of customer wait time, and the percentage of orders on time. The plan also identified baseline and annual performance targets for these metrics to use in measuring progress. But it did not have any cost baselines or cost performance targets. Furthermore, DOD has not yet identified specific outcome metrics for many of the initiatives. For example, DOD's plan shows that it expects to have radio frequency identification technology implemented at 100 percent of its U.S. and overseas distribution centers by January 2007, but noted that it has not yet identified additional metrics that could be used to show the impact of implementation on expected outcomes, such as receiving and shipping timelines, asset visibility, or supply consumption data. In total, DOD's plan identifies a need to develop such supply performance metrics for 6 initiatives, and 9 of the 10 initiatives lack cost metrics. Until DOD develops and tracks the additional costs and supply impact metrics it has promised, it will be difficult for the department to convincingly demonstrate its progress in improving supply chain management and providing timely logistics support to the warfighter.

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## GAO Has Plans to Follow Up on DOD's Supply Chain Improvement Efforts

As part of our periodic reassessment of high-risk areas across the federal government, we will be assessing DOD's progress in resolving supply chain management and its other high-risk areas. Our next high-risk update is due in January 2007. We plan to follow up on DOD's supply chain management improvement efforts in three ways. First, as a matter of routine practice we will continue assessing DOD's progress in implementing the recommendations made in our prior reports. Second, we also anticipate evaluating several of DOD's supply management activities as part of our planned engagements over the next 2 years. For example, next year we expect to evaluate how the Defense Logistics Agency's and services' spare parts inventory management initiatives have progressed in meeting their performance objectives and timelines. Third, in August we met with representatives of the Department of Defense Office of Inspector General and service audit agencies as well as DOD and OMB to review DOD's plan and begin the process of sharing information on planned audits. We expect to meet periodically with these representatives in the future to coordinate audit coverage of the initiatives, performance metrics, and data system validity while minimizing audit duplication.

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Along with OMB and the Congress, we look forward to doing our part by monitoring DOD's progress as it works toward mitigating supply chain management problems and achieving its goal of supporting the warfighter by providing the "right items to the right place at the right time."

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Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I would be happy to answer any questions you may have at this time.

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## Staff Contacts and Acknowledgments

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